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## UNITED STATES BANKRUPTCY COURT

## EASTERN DISTRICT OF CALIFORNIA

UNITED STATES BANKRUPTCY COURT  
EASTERN DISTRICT OF CALIFORNIA

In re: ) Case No. 05-40218  
 ) Docket Control No.: none  
 LEO GONSALVES, )  
 WENDY GONSALVES, ) Date: July 6, 2006  
 ) Time: 1:00 pm  
 Debtors. ) Dept. D

MEMORANDUM DECISION

Drive Financial Services LP (the "Creditor") has objected to the Chapter 13 Plan filed on March 28, 2006 (the "Plan") proposed by Leo and Wendy Gonsalves (the "Debtors"), on grounds that (1) the Plan was proposed in bad faith, (2) the interest rate proposed in the Plan for the Creditor's secured claim is too low, and (3) the collateral value proposed in the Plan is too low. The Creditor's objection applies specifically to the inclusion of a claim in the Plan for debt incurred to the Creditor after the Debtors had filed a chapter 7 petition but prior to converting their case to chapter 13.

For the reasons set forth below, the court will confirm the Plan and will overrule the Creditor's objection to confirmation.

I. MATERIAL FACTS

The record in this case shows that the Debtors filed a petition for chapter 7 relief on October 15, 2005, before the general effective date of the Bankruptcy Abuse Prevention and Consumer Protection Act. At that time, the Debtors did not have bankruptcy counsel. On February 25, 2006, approximately four months after filing their chapter 7 petition, the Debtors entered into a Retail Installment Sale Contract Simple Interest Finance Charge (the "Contract") through Golden State Mitsubishi-Suzuki (the "Dealership"). The Contract provides for a security interest in a 2004 Pontiac Bonneville (the "Vehicle"). Rights under the Contract, including the security interest, were subsequently assigned to the Creditor.

1 The Debtors obtained counsel for the first time with regards to their bankruptcy  
2 proceeding on March 25, 2006, after the United States Trustee filed a § 707(b) motion ("UST's  
3 Motion") and the court entered a conditional order of dismissal. Rather than having their chapter  
4 7 case dismissed and then filing a chapter 13 case, the Debtors filed a motion to convert their  
5 chapter 7 case to chapter 13.

6 The Contract price for the Vehicle is \$15,856.62 and the interest rate set forth in the  
7 Contract is 24.99% per annum. The Plan values the Vehicle at \$12,009.00 and provides for an  
8 interest rate of 8% per annum on the Creditor's secured claim.

## 9 10 II. ANALYSIS

11 The issues in this case are: (1) whether the Plan was proposed in bad faith, (2) whether the  
12 interest rate proposed by the Plan is appropriate, and (3) whether the Plan appropriately values  
13 the Vehicle.

### 14 15 **A. Good Faith**

16 In determining whether a debtor has filed a chapter 13 plan in good faith, courts must look  
17 to the totality of the circumstances. In re Ho, 274 B.R. 867, 876 (B.A.P. 9th Cir. 2002) (quoting  
18 In re Eisen, 14 F.3d 469, 470 (9th Cir. 1994)). When taking this approach, courts are unlikely to  
19 find bad faith unless there is strong evidence supporting such a finding. See In re Metz, 820 F.2d  
20 1495 (9th Cir. 1987) (holding that the debtor's chapter 13 plan was not filed in bad faith  
21 notwithstanding the fact that it provided for no payment to unsecured creditors); In re Smith, 286  
22 F.3d 461 (7th Cir. 2002) (availing oneself to the more liberal provisions of chapter 13 to  
23 discharge a debt that was not dischargeable under chapter 7 is not alone sufficient to constitute  
24 bad faith, and the payout of less than ten percent of the debt under the chapter 13 plan, while a  
25 red flag, was not proof of bad faith); In re Young, 237 F.3d 1168 (10th Cir. 2001) (holding that  
26 the debtor's post-petition purchase of a luxury car did not compel a finding of bad faith because  
27 there was ample evidence that the chapter 13 plan was not filed for the purpose of evading that  
28 debt).

1 The Creditor argues that the Debtors entered into the Contract while in chapter 7, with the  
2 intent of converting the case to chapter 13 in order to undervalue the collateral and cram down  
3 the interest rate that is provided in the Contract.

4 The Creditor offered no tangible evidence of the Debtors' intent at the time of entering  
5 into the Contract, but instead invites the court to infer an improper purpose from the timing of  
6 events. The Debtors allege that they advised the Dealership of their pending chapter 7 case, but  
7 offer no declaration in support of that allegation. Thus, neither party has offered specific  
8 evidence to show intent. The court does note however, that the Debtors did not retain counsel  
9 until roughly one month after purchasing the Vehicle. It is unlikely that the Debtors, without  
10 counsel at the time of entering into the Contract, were intending to convert their case to chapter  
11 13 after purchasing the Vehicle. This observation is supported by the fact that the Debtors  
12 converted their chapter 7 case to chapter 13 while facing a possible dismissal due to the UST's  
13 Motion. Facing the dismissal of their case is a more likely source of motivation for the Debtors'  
14 conversion than some deliberate scheme that they hatched prior to retaining legal counsel.

15 In In re Street, 55 B.R. 763, 764-65 (Bankr. N.D. Cal. 1985), the court found no bad faith  
16 in the debtor's proposed chapter 13 plan even though he converted after a court determined that  
17 one of his debts was nondischargeable under chapter 7. Like the debtor in Street, the Debtors in  
18 this case have converted their case from chapter 7 to chapter 13 and are attempting to include a  
19 debt in the Plan that would not have been eligible for discharge in the chapter 7 case. Unlike the  
20 debtor in Street however, the Debtors in the present case are not trying to include a debt that has  
21 been expressly judged to be generally nondischargeable under chapter 7. The Debtors are merely  
22 attempting to include a regular consumer-type debt in the Plan. Since the court found no bad  
23 faith in Street, it logically follows that no bad faith exists in the present case.

24 Furthermore, the Supreme Court has held that a debtor may file chapter 7 and chapter 13  
25 petitions sequentially. Johnson v. Home State Bank, 501 U.S. 78, 87 (1991). Accordingly, if the  
26 Debtors had chosen to let their chapter 7 case run its course and subsequently file a chapter 13  
27 petition, then there appears to be little doubt that the debt incurred with the Creditor could be  
28

1 properly included in the Plan. The Debtors have merely chosen to simplify the process by  
2 converting directly to chapter 13.

3 Based on the foregoing analysis, the court finds that the Creditor has not introduced  
4 evidence into the record that is sufficient to demonstrate that the Debtors acted in bad faith by  
5 including the debt incurred through the purchase of the Vehicle in the Plan. Rather, the logical  
6 inference is that the conversion was motivated by the UST's Motion.

### 7 8 **B. Proposed Interest Rate**

9 The Creditor next contends that the interest rate proposed by the Plan is inappropriate. In  
10 chapter 13 cases, the appropriate interest rate should generally be determined by first looking to  
11 the national prime rate, reported daily in the press, and then adjusting that rate for the risk of  
12 default. Till v. SCS Credit Corp., 541 U.S. 465, 478-79 (2004). It should also be noted that  
13 "starting from a concededly low estimate and adjusting upward places the evidentiary burden  
14 [regarding the risk adjustment] squarely on the creditors." Id. (emphasis added).

15 The record indicates that the national prime rate was 6.5% at the time of the conversion  
16 from chapter 7 to chapter 13. The Plan proposes a 1.5% adjustment to add to the prime rate in  
17 order to account for the risk of default, creating a total rate of 8% per annum. The Creditor  
18 asserts that the 8% interest rate proposed is too low and that the appropriate rate is 24.99% per  
19 annum, the original rate stated in the Contract. However, the Creditor has introduced nothing  
20 into the record to refute either (1) that 6.5% is the appropriate prime rate to be used in the Plan, or  
21 (2) that 1.5% is an appropriate adjustment to account for the risk of default. Therefore, under the  
22 reasoning set forth in Till, the Creditor has not met its evidentiary burden in a manner that  
23 warrants an upward adjustment of the interest rate proposed in the Plan. See id.

### 24 25 **C. Value of Collateral**

26 In cases such as the present one, where the debtor has invoked the cram down power, the  
27 value of a security interest held by a creditor is most adequately determined by the replacement-  
28 value standard. Assocs. Commercial Corp. v. Rash, 520 U.S. 953, 965 n.6 (1997). The

1 replacement-value is the cost the debtor would incur to obtain a like asset for the same purpose.  
2 Id. at 965.

3 The valuation of the Vehicle in the Plan is based on the Kelley Blue Book  
4 (www.kbb.com) "private party" value, which is what a buyer can expect to pay when buying a  
5 used car from a private party. See  
6 www.kbb.com/kb/ki.dll/ke.kb.sp?kbb::CA067;&95610&&usedCars:slp& (page to input criteria  
7 for trade-in, retail, or private party values). The Kelley Blue Book value also adjusts the  
8 estimated value of vehicles depending on whether they are in "excellent," "good," or "fair"  
9 condition. The Debtors' valuation of \$12,009.00 is based on the allegation that the Vehicle is in  
10 "fair" condition. This allegation remained undisputed by the Creditor.

11 Meanwhile, the Creditor proposes a \$14,775.00 minimum valuation of the Vehicle, which  
12 is based on a N.A.D.A. Official Used Car Guide (www.nada.com) report. The N.A.D.A. report  
13 provides the estimated *retail* value of the Vehicle. However, the N.A.D.A. retail value may not  
14 be properly indicative of the replacement-value in this case, because it fails to state the condition  
15 of the car which it is evaluating. Furthermore, due to the negotiable nature of vehicle prices,  
16 retail values are generally higher than what a consumer would expect to actually pay for a used  
17 vehicle, which means that the N.A.D.A. estimated retail value submitted by the Creditor likely  
18 overestimates the replacement-value of the Vehicle.

19 The other valuation of \$15,056.80 proposed by the Creditor is even higher than the  
20 N.A.D.A. estimate, which means it likely overstates the replacement-value of the Vehicle as well.  
21 In support this higher valuation, the Creditor offers itself as an expert on the subject of vehicle  
22 valuation. However, the Creditor is not an unbiased party in this case, so its expert opinion is  
23 weighed accordingly. See United States v. Fell, 372 F. Supp. 2d 786, 790 (D. Vt. 2005) ("Expert  
24 witness testimony should be judged for credibility and bias on the same basis as other testimony."  
25 (citing Sartor v. Ark. Natural Gas Corp., 321 U.S. 620, 627-28 (1944))).


26 Of the various methods of valuation proposed, the methodology used by the Kelley Blue  
27 Book is most conducive to producing an accurate estimate of the Vehicle's replacement-value.  
28 Thus, the Debtors' proposed valuation of \$12,009.00 is accepted by the court. The court

1 therefore finds that the Plan's treatment of the Creditor's secured claim satisfies 11 U.S.C.  
2 §1325(a)(5) and (b)(1).

3  
4 **III. CONCLUSION**

5 The record demonstrates that the Debtors filed the Plan in good faith. Further, the court  
6 finds that the proposed interest rate and value of collateral in the Plan satisfy the statutory  
7 requirements under the circumstances of this case. Accordingly, the Debtors' Chapter 13 Plan  
8 will be confirmed and the Creditor's objection to the plan confirmation will be overruled. The  
9 court will issue an order consistent with this memorandum.

10  
11 Dated: July 21, 2006

  
12 ROBERT S. BARDWIL  
13 United States Bankruptcy Judge  
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Certificate of Service

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